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SUBJECT: XIAMEN AIRLINES: LOYAL BOEING CUSTOMER LOOKS AHEAD
TO FLIGHTS TO TAIWAN

REF: GUANGZHOU 14846

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1. (SBU) Summary. Xiamen Airlines, a regional airline whose biggest shareholder is China Southern Airlines, plans to add 30 new Boeing aircraft to its fleet by 2010, augmenting its current all-Boeing fleet of 35. The fleet's simple structure is credited in part for helping the airline confront rising fuel costs. Most of the airline's 145 routes serve Fujian, where it enjoys a 50% market share; its current expansion focuses on routes between Fujian and China's largest cities, as well as increasing its presence in the Yangtze River Delta. Looking ahead, the airline's attention is firmly set on Taiwan and the eventual resumption of direct cross-straits flights. Fujian enjoys close, long-standing ties to Taiwan, and Xiamen Air's stronghold in the former should allow it to capitalize once direct flights resume. Curiously, and as opposed to other Chinese airlines, Xiamen Air does not have a preference for military aviators, looking instead for fresh university graduates. End summary.

Company profile

2. (SBU) At a June 15 meeting in Xiamen, Xiamen Airlines officials Huang Guohui and Lin Yingru discussed the airline's situation. The airline (also known as Xiamen Air and by its two-letter ICAO code: MF) started operations in 1984. China Southern Airlines is its majority shareholder (60%), with Xiamen C & D Company owning the remaining 40% of shares. Xiamen Air's share of the Chinese market is between 5% and 6%, and it has turned a profit for 19 consecutive years, although rising costs have recently taken a toll on its earnings. The airline's after-tax net profit for 2005 was roughly USD 9.5 million, down 56.51% year-on-year. In the same year, the airline carried more than 6.92 million passengers, up 11.1% year-on-year.

A loyal Boeing customer

¶3. (U) MF operates an all-Boeing fleet, composed of nine 757s and 26 737s (one -800, 15 -700s, six -500s, and four -300s). The average age of its aircraft is seven years. MF is set to acquire six more 737-800s by the end of 2006, and plans to enlarge its fleet to 65 aircraft by 2010, purchasing Boeing jets exclusively.

¶4. (SBU) Huang attributes part of the airline's relative financial success to its decision to only operate two kinds of aircraft (and then mostly 737s). In particular, this simple structure makes it easier to implement fuel-saving measures across the fleet. It also reduces the need for crew training, and allows greater flexibility in dispatching flight crews. By contrast, China Southern's hodgepodge of a fleet has the opposite effect. MF also saves on costs by handling its own maintenance and catering, and by offering financial rewards to flight crews that manage to save fuel.

Fujian's airline

¶5. (U) MF flies 145 routes, most of which serve the province of Fujian. In addition to its main hub at Xiamen Gaoqi Airport, the airline has three other bases in Fujian: Fuzhou, Jinjiang-Quanzhou, and Wuyishan. MF presently holds a 50% market share in Fujian, which it hopes will increase to 55% by 2010. The airline also has a base in Nanchang, in the neighboring province of Jiangxi. It expects to hold a 30% market share in Nanchang by 2010.

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Modest expansion plans

¶6. (SBU) The airline's current expansion efforts are modest by Chinese standards. In addition to strengthening routes from the country's main cities to Fujian, the airline wants to increase its presence in the Yangtze River Delta (YRD). For this purpose, MF is setting up a new base in Hangzhou, 112 miles southwest of Shanghai. (Note: The central government has already approved plans for a maglev, or magnetic levitation, train line between Shanghai and Hangzhou, which would connect the two cities in less than 30 minutes. A maglev line already connects Shanghai's Pudong district with the city's international airport. End note.) The Hangzhou base only flies two planes at the moment, but MF hopes to increase the number to ten by 2010. MF already has a 13.2% market share in Hangzhou, and hopes it will grow to 20% by 2010.

Small international network

¶7. (SBU) Xiamen Air's international presence is limited. MF now flies from both Xiamen and Fuzhou to Macau, Kuala Lumpur, and Singapore, and it has flights to Hong Kong from all four of its Fujian bases. From Xiamen the airline also flies to Bangkok, Penang, Tokyo, Osaka, and Seoul. Meanwhile, MF already flies to Macau and Bangkok from its budding base in Hangzhou. Although the airline plans to seek out new international destinations in nearby Asian countries, the focus of its future expansion will be on domestic routes, and on Taiwan.

Eyes set on Taiwan

¶8. (SBU) As mentioned in paragraph 6, Xiamen Air's current expansion efforts are rather timid. However, the airline is clearly holding its fire until the reestablishment of regular flights between Taiwan and the mainland. As the strongest airline in Fujian, MF will be in an ideal position

to cash in once cross-straits flights are once again possible. Fujian and Taiwan have long-standing ties, which are being reinforced by streams of investment from Taiwan. MF is not shy about publicizing its hopes, and its officials view the airline's successful New Year flights to Taiwan as an auspicious sign. (Note: Mainland and Taiwan authorities allow a limited number of direct flights during the Lunar New Year. Last year, Xiamen Air Vice President Song Chengren flew the special season's first flight. He declared that flying into Taipei had been "the greatest dream of [his] career". End note.) Xiamen Air has already established a partnership with a Taiwan airline, TransAsia Airways, allowing passengers to travel between destinations in the mainland and Taiwan via Xiamen and Jinmen, a Taiwan-controlled island near Xiamen (see reftel).

Give us the nerds, not the jocks

¶9. (SBU) In contrast to some of its domestic competitors, MF does not prefer to recruit pilots from the ranks of the military. Instead the airline focuses its recruitment efforts on universities, and was in fact the first Chinese airline to recruit fresh college graduates. According to Huang, these graduates are more educated and intellectually capable than the pilots leaving the service. In particular, he praised the English language skills of the college graduates. This preference, combined with the airline's relatively small size, has allowed MF to bypass the effects of a nationwide pilot shortage.

Low-cost threat?

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¶10. (SBU) Referring to the airline start-ups that are being established across the country, Huang agreed that only a few are likely to survive an eventual stabilization of the market. However, in the short term these airlines will inconvenience the more established carriers, by increasing competition for pilots and bringing down prices.

Comment: Happy times ahead for the Egret?

¶11. (SBU) It is hard to find an official in Fujian that will not insert the phrase "the western shore of the Taiwan Straits" in every other sentence, referring to the province and its government's plans to capitalize on improving cross-straits ties. Having seen its progress hampered in the past because of tensions between Taiwan and the mainland (and the central government's fear of dropping economic resources in a potential war zone), Fujian is now keen on using its proximity to Taiwan's strong economy to spark its own economy. Already a preferred destination for Taiwan investment dollars, Fujian stands to benefit greatly from more normal relations, and a consequent increase in trade, between the mainland and Taiwan. The lack of direct flights between Fujian and Taiwan is one of the remaining anomalies in what has become a vibrant economic relationship, boosted of course by the profound historical ties between both provinces. Once such flights become possible, a wildly promising market will open, and Xiamen Air will be ideally placed to tap it to its benefit.

¶12. (SBU) At the same time, success in Taiwan may ironically spell the end for Xiamen Air, whose symbol is an egret. In some ways, MF is already a subsidiary of its majority owner, China Southern. The airlines do not really compete in the markets they both fly, instead complementing one another. At Guangzhou Baiyun Airport, MF shares China Southern's hub terminal, and China Southern's frequent flyer program gives credit for miles flown on MF. A future switch from niche player to cross-straits star may make MF too much of an attractive takeover target for the Guangzhou-based giant.

China Southern's financial situation is delicate, and the airline would probably welcome a larger take from the promising mainland-Taiwan market.

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